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Richard L. Sallquist
Sallquist, Drummond & O'Connor, P.C.
4500 South Lakeshore Drive
Suite 339
Tempe, Arizona 85282
Phone: (480) 839-5202
Fax: (480) 345-0412

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF OAK CREEK WATER COMPANY NO. 1 FOR A RATE INCREASE.	DOCKET NO. W-01392A-07-0679 **APPLICANT'S OPENING BRIEF**

The Applicant, Oak Creek Water Company No. 1, (the "Applicant" or the "Company") hereby files its Opening Brief in accordance with the direction of Administrative Law Judge Teena Wolfe at the hearing on this matter on August 5, 2008.

I. INTRODUCTION

The Company filed an Application on December 7, 2007 requesting an increase in its authorized rates and charges that were established by the Commission in Decision No. 64198, dated November 8, 2001. At the end of the December 31, 2006 Test Year, the Company served 646 customers, comprised of 562 single-family residences, 45 multi-family residence, and 76 commercial customers. (Exhibit A-1, Rebuttal Schedule H-2, Page 1)[1]. The average monthly charge for a 3/4 inch single family residential customer using at 7,994 gallons per month would

[1] The Company and Staff's cases are set forth primarily in single Exhibits, A-1 for the Company consisting of Thomas Bourassa's Testimony and Schedules, and for Staff, Exhibit S-2, Darren Carlson's Testimony and Schedules. For simplicity of citations we will cite only the testimony Page and Schedule numbers.

increase by $3.26 per month, or 14.55%. (Schedule H-2, Page 2, and Bourassa Testimony, Page 25).

The December 7 filing utilized the Commission's "short form" application, based upon prefiling discussions between Company and Staff representatives. On January 29, 2008, the Staff filed a Sufficiency Letter indicating that the Company was a Class C utility. On February 28, 2008, a Procedural Order was issued setting, among other things, the Hearing Date and testimony filing dates for the parties. On July 24, 2008, the Company did file testimony and exhibits pursuant to that Procedural Order, and in accordance with AAC R 14-2-103. Because the Application is being processed as a Class C, not the Class D filing as made on December 7, 2007, the Company is relying solely on the Class C rebuttal filing in this case.

The July 24 filing requested that the Commission establish a Fair Value Rate Base ("FVRB") of $465,600 and grant an authorized annual increase in revenues of $68,057, or a 25.10% increase overall. (Schedule A-1). The Company also proposed revisions to the rate design consistent with past Commission approval (Transcript of Proceedings, Page 50)[2], but with the monthly minimums further adjusted to recognize the concept of "gradualism". It also proposes breakpoints within the proposed tiers recognizing the various meter size usage patterns. (Please see Section IV below)

Staff filed its Testimony and Exhibits in responds to the December 7, 2007 Application, and did not offer any adjustment to that position following the Company's Rebuttal Class C filing, except pertaining to the FVRB as discussed below. Staff recommended a revenue increase of $45,631, for an increase of 16.83% (Schedule DWC-1). The average single family residential

[2] The Transcript of the Proceeding will be hereinafter cited as (TR___)

customer's monthly increase would be $2.11, or 9.4% under the Staff's Recommendation (Schedule DWC-7). Staff's proposed rate design applies a percentage increase to monthly minimums, with identical break points for all meter sizes.

II. RATE BASE

Staff agreed that the Company's proposed FVRB, including the slight difference in the Accumulated Depreciation, was acceptable in this case. (TR 117). The Company stipulated to using the Original Cost New Depreciated ("OCLD") rate base value as the FVRB (TR 19). Therefore, the parties agree that the FVRB for this proceeding should be $465,600.

III. OPERATING EXPENSES

The parties have agreed to levels of Operating Expenses for numerous operating accounts as set forth on Schedule C-1, Page 1, and Schedule DWC-4, respectively. They include the following:

Outside Services	$4,920
Water Testing	$3,409
Rents	$0
General Insurance	$5,323

There are, however, certain expense items on which the Company and Staff disagree. Those items are set forth in summary format on Attachment One hereto. We will address each expense item serially as found on the NARUC Chart of Accounts and on that Attachment.

SALARIES AND WAGES

Some of these differences in the recommendations of the Company and Staff on these expense items may seem insignificant, but for a small-customer owned company, <u>all</u> cost recovery is critical. One of the major differences relates to the Salary and Wages Account. That difference totals $10,700 and is due primarily to the fact that the Staff failed to annualize the known and measurable changes to the Company's personnel roster. The Company identified the year-end employees in Schedule C-2, Page 3.1, where Mr. Bourassa provided the employee roster, including the two ex-employees and the one new employee, for a total of four current employees and their Base Wages. He computed salaries for only those four individuals as if employed for the full year. (TR 22 & 54) That results in an annual Salary & Wages Expense of $139,964, $10,700[3] more than the Staff's recommendation. Mr. Bourassa then computes the Payroll Taxes for those employees, and decreased that amount by $598. These adjustments are summarized on Schedule C-2, Page 3; C-1, Pages 1 and 2; and, on the Income Statement at C-1, Page 1 Lines 7 & 23. These are clearly known and measurable charges to the 2006 Test Year. This is a bare-bones employee base with modest salaries, all of whom are critical to assure safe operation of the system and quality service to the Company's customers.

Staff also failed to annualize the four employees' salaries and benefits and overlooked $2,400 in health benefits for the new Office Manager. (TR 25 & 77).

All of the Company's recommended Salaries and Wages of $139,064 should be allowed.

REPAIRS AND MAINTENANCE

The next major expense where the parties have a disagreement is in the Repairs & Maintenance Account. The Company believes that the expense level expressed in current dollars will be approximately $18,721. Staff concludes that it will be only $14,280. By definition, repair and maintenance expenses do not occur in a straight line, they can vary substantially from

[3] The difference from the Company's original filing is $13,910 as stated in Exhibit G2, Page 3.1, but the difference from Staff's recommended expense level is $10,700.

year to year. To normalize this fluctuating expense the Company reluctantly agreed that an averaging of yearly expenses is appropriate. (TR 28). The time and methodology are what is at issue. (TR 56). First, the Company operates a relatively old system. Schedule B-1, Page 1 illustrates that the Company's Plant in Service is 64% depreciated. Repair expenses are bound to increase going forward. Staff uses a six-year average to determine the Test Year expense. They include a year with a very small $3,169 expenditure. Whether that year's deviation was caused by fortuitous operations, or by lack of cash to conduct such repairs, is not reflected in the record, but including that year clearly skews the Staff's average. The Company's proposed three-year period, which it believes is more representative of the repair and maintenance expenses it will face on a going forward basis. (TR 30).

Further, Staff did not recognize that the materials and repair costs for those operations have increased in either a three-year or a six-year period. (TR 140). Mr. Bourassa used a well-established method to reflect this reality. At Schedule C-2, Page 6.1, he sampled the actual repair invoices of the Company to determine what type of plant was being repaired. He then prepared an equally weighted "basket" of seven categories of expenses, and determined that using Staff's six-year period, the average increase in those costs was 6.05% based upon the Handy-Whitman Index. (TR 151-161). Handy-Whitman is the industry standard for establishing current costs of historic utility plant construction. Applying that factor to the recent actual cost results in a $18,721 average cost. (Schedule C-2, Page 6). The averaging of unadjusted cost items within the same time frame is a fair and reasonable method to normalize a cost. Costs over future periods must always be "present valued", just as cost over historic periods must be inflation-adjusted. (See TR 122). This customer owned company, located in the rocky soil, hilly, high desert community of Sedona, must have sufficient funds to maintain its facilities both for proper service, and water for conservation purposes. The Company's proposed expenses expressed in current dollars of $18,721 should be allowed.

OFFICE SUPPLIES

Staff agrees that natural gas and waste services to the Company's offices are legitimate expenses. (TR 121). The filing consolidated the Office Utility Account with the Purchased Power Account. The Office Utility Account clearly has no part in water production, so those costs were properly removed to accurately reflect only the Company's pumping costs. However, Staff failed to complete the second half of the transaction by reclassifying those gas and waste costs to the Office Supplies Account. Mr. Carlson stated these costs should be recovered in a rate case. It is submitted that a review of these proposed expenses can conclude they are reasonable even without a full "audit". (See also TR 137).

Mr. Bourassa has included these costs in the Company's Office Supplies Account found on Schedule C-2, Page 4. Staff's exclusion of these costs, or not requesting supporting documents, was clearly an oversight at the initial analysis, but the $619 should now be included in the authorized expenditures of the Company.

TRANSPORTATION EXPENSES

There is no evidence, or even a suggestion, that any use of the Company's single vehicle was used improperly during the Test Year. (TR 127). There is substantial evidence that the cost of gasoline for that vehicle increased substantially following the Test Year. Mr. Bourassa accepted the Staff's amortization of certain items in this account, but then recomputed the actual gasoline bills to recognize current cost to utilize a $4.00 per gallon average cost, with a $3.97 to $4.19 range. (Bourassa, Page 15 & TR 142). He confirmed the accuracy of that average gas cost the day before the hearing on this matter. (TR 32). At a time when everyone has knowledge of the reality regarding increasing gas costs, certainly the Commission should normalize this expense. The difference in the Staff's and the Company's recommended Transportation Expenses is $925, and the Commission should allow the Company's proposed $5,227 as the reasonable expense.

HEALTH INSURANCE

There was some reclassification of Insurance Expense associated with employees by the Company and Staff, and for the most part the parties agree on that reclassification. (TR 101) However, the government-mandated Workers Compensation Insurance cost was not included by the Staff for the annualized salary of the Office Manager. That cost is a simple computation tied to the wages as set forth on Schedule C-2, Page 13. (TR 38 & 80). The Company needs the $1,507 in question for payment of these real payroll related costs associated with real wages.

RATE CASE EXPENSE

There was substantial discussion during a hearing as to why the Company filed a Class D rate case application, and not a Class C filing. The significant fact in that discussion was that the initial filing, rightly or wrongly, assumed that there would be no hearing and no briefs required. Therefore, the original rate case expenses were estimated to be $10,000 and proposed to be amortized over a three year period. When it became apparent that a hearing and legal briefs would be required, the Company's Rebuttal filing reflected the estimated expenditure of $25,000. The Company detailed that estimated expense on Schedule C-2, Page 14 at $25,000. At Judge Wolfe's request, the Company late filed Exhibit A-2 on August 15, with actual expenses through July 31, 2008, and projected remaining cost totaling $29,217. The Company's Rebuttal filing was obviously conservative. Staff testified that they had no opinion as to the reasonableness of the Company's $25,000 rate case expense. (TR 118). Mr. Bourassa testified that typical Class C companies' rate case expenses far exceed the requested amount. (TR 135).

The Company's proposed amortization period was based upon the Board of Directors' established policy that the Company would file rate cases on a three-year cycle (not inconsistent with the Commission's desire). However, in deference to Staff's proposed five year amortization, Mr. Bourassa proposed amortizing those expenses over four years. Staff maintains its original position of using a five-year amortization of the initial $10,000 estimated cost.

It is unfortunate that rate case expense are as high as they are, but the 2006 costs and the amortization period are reasonable and appropriate at $25,000 with a recovery over over a four year period, or $6,250 in Rate Case Expenses.

MISCELLANEOUS EXPENSES

Again, this Staff disallowance of $1,292 is not big dollars, but the Company is operating a technical business with many personnel, vendor, and customer interfaces. The Company set forth the requested Miscellaneous Expense items in Schedule C-2, Page 16, which the Staff is proposing to disallow. Mr. Bourassa explained why each of these expenses is necessary and reasonable and the Commission should allow them to permit normal operations of this company and to serve its customers. (TR 36 & 77).

IV. RATE DESIGN

The Company's existing rate design is inappropriate for revenue recovery or conservation. (TR 42) In the initial Class D filing, the Company did not propose any changes to the rate design because sufficient data for redesign was not required to be compiled or filed with that Application. In the Class C filing, the standard Rule 103 H Schedules were filed and the recently favored tiered rate design was proposed. Based upon that data, (Schedule H-4) the Company proposed a three tier system for the small meters, both residential and commercial, and a two tier design for the larger meters. The break points for the respective tiers are based upon the consumption data of the various size meters, with one additional important consideration.

The existing design is flawed due to its failure to charge larger meters based upon that meters' flow capacity. To immediately impose the design that the Commission typically adopts (i.e., monthly minimums based on the ratio of the flow capacity of the large meters to the flow capacity of a 5/8" meter) would result in the large meter customers suffering substantial rate shock and would further be inconsistent with the well-established doctrine of gradually increasing rates to the ultimate or appropriate levels. Recognizing this, Mr. Bourassa has proposed setting the monthly minimum for all meter sizes over 1 inch, based upon 50% of those meters actual flow for this proceeding (half scaling the increase), with the appropriate allocation (full scaling) to be implemented at a future rate case. (Bourassa Page 18 & TR 45, 63-67).

Both parties propose a three tier commodity charge for the 5/8 x 3/4 inch single-family residential meters (Schedule H-2 and Schedule DWC-6). However, Staff proposes that the multi-family units and all commercial meters have only two tiers with identical break points between the tiers. (Schedule DWC-6). The Company believes that this is inappropriate. The data for the larger meters begs for a two tier design, with those breakpoints tied to the different usage levels. (Schedule H-3, Pages 1 & 2). Staff arbitrarily sets the break points between two tiers at 25,000 gallons. The Company proposes the traditional method of establishing different break points for different size meters to recognize the different consumption patterns of those various customers.

With the large number of 3/4" multi-family residential unit customers of the system, namely 45, (Schedule H-2, Page 3), representing 212 units, the Company believes it is appropriate to maintain establishment of multi-unit monthly minimums based on the number of units, and the tiers for these customers tied to the single meter tier. Those customers pay a 3/4" meter monthly minimum for each unit in their respective complex, i.e., a four-plex pays four times the 3/4" monthly minimum. Because the consumption of four units being served by one meter would obviously be more than a single-family residence, the gallons included must reflect that reality. (TR 69-74) The Company proposes using a multiple of the top tier of the second tier to establish that breakpoint. (Bourassa, Page 18 & TR 46) This rate design was discussed with, and approval by, the Company's Board of Directors, based on their knowledge of their customers. (TR 143). Staff is proposing a rate design with set break points and no scaling of these levels, a "one-size fits all" approach. (TR 49).

Some concern was expressed at the hearing as to the efficacy of promoting conservation with such a high breakpoint because each resident of the hypothetical six-plex is not individually responsible for conservation. Mr. Bourassa explained that it is anticipated that the individual property owner/manager would monitor this, and if they believe a tenant to be irresponsible, the landlord would invoke economic incentives to encourage appropriate usage. (TR 73). It is submitted that the alternative of requiring separate water meters to each unit so that tiers can be applied to each unit would be economically, if not physically, prohibitive for these customers.

The present rate design is seriously flawed. Establishing the "perfect" rate design in one single step is not a realistic goal in this proceeding. The Staff proposed <u>changes</u> to the rate design, but does not improve it. The Company proposal is an <u>improvement</u> to the existing rate design and a <u>step</u> in the right direction, so that the rate design adopted in the next rate case can be appropriately designed for revenue recovery and conservation promotion. The Commission should adopt the Company's proposed rate design.

V. CONCLUSION

This case is unique, even among unique rate cases. The differences in total revenues between the Company and the Staff positions are substantial, but the difference in the impact upon the typical ¾ inch single-family residential customer is nil.

The revenue difference is $23,734, or 8.27% of the Company total revenues, but the difference for that typical customer in the Company's proposed $ 3.26, 14.55%, increase and Staff's proposed $2.11, 8.30% increase, is only $1.15 per month. Although the Commission is obviously the ultimate arbiter of any increase, the Company's Board of Directors requests, explains, and defends the requested rate increases to its Members. The Board has approved this request and the proposed rate design only after consultation with the Company's consultant, and after considering the alternatives and the impact for its Member customers.

The parties' differences in expense allowances are relatively few, with three items, the Salary & Wages Account, the Repairs & Maintenance Account and the Rate Case Expense Account, comprising over 80% of those the differences. Recovery of not just those, but all expenses, is essential to the Company's reasonable on-going operation. The Staff recommend an 11% Operating Margin which would generate $34,822 in Operating Margin. If the $23,734 in expenses request by the Company is denied, the Company has only $11,088 of that Operating Margin for those disallowed functions. This creates uncomfortable and unnecessary pressure on these owners and operators of the Company in their efforts to assure sufficient water and customer service.

The Company's witness has explained why each of the Company's proposed adjustments to these expense items are reasonable and needed. Staff was understandably pressed for time to do its analysis due to departing personnel, but did not present compelling evidence that the Company's adjustments were inappropriate, but argued that the Company's adjustments were merely not fully analyzed or unsupported. In that scenario, Company believes it is appropriate to allow these expenses; after all, the worst-case scenario is that Staff is totally correct and the Company has "over-estimated" its expenses with the result that the Company's reserves grow for the benefit of its customers

The Company's proposed rate design is a transition design, intended to adopt the Commission's traditional rate design based upon the normal cost of service considerations, but reflecting normal parameters relating to meter sizes. The Company does propose lessening the impact of monthly minimums and tier levels by "half scaling" these charges in this proceeding. Full implementation would be proposed in the next rate case.

The Company believes the modest expense levels and the transitional rate design result in just and reasonable rates for the benefits of the customers of this Company, and that the Commission should grant the Application as requested.

DATED this 29TH day of August, 2008.

SALLQUIST, DRUMMOND & O'CONNOR, P.C.

By:

Richard L. Sallquist
4500 South Lakeshore Drive, Suite 339
Tempe, Arizona 85282
Phone: (480) 839-5202
Fax:(480)345-0412
Email: dick@sd-law.com

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Original and ten copies of the foregoing filed this 24th day of August, 2008:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Copies of the foregoing Hand Delivered this 25th day of August, 2008 to:

Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

71014.00000.21

OAK CREEK WATER COMPANY

Parties' Position Comparisons

Docket No. W-01392A-07-0679

2006 Rate Case

Item	Company	Ex A-1 Sch C-2	Bourassa Test. Page	Staff	Ex S-2 DWC Sch	Carlson Test. Page	Difference
EXPENSES							
Salary & Wages	$ 139,964	3.1	9	$ 129,264	5A	10	$ 10,700
Repair & Maintainence	$ 18,721	6	12	$ 14,280	5C	10	$ 4,441
Off Supplies (Utilities)	$ 10,099	4	12	$ 9,480	5D	11	$ 619
Transportation	$ 5,227	11	15	$ 4,302	5H	12	$ 925
Health Ins (Workers Comp)	$ 1,507	13	15	$ -	5J	12	$ 1,507
Rate Case Exp	$ 6,250	14	16	$ 2,000	5K	13	$ 4,250
Misc Exp	$ 1,417	16	17	$ 125	5O	14	$ 1,292
	$ 183,185			$ 159,451			$ 23,734

Attachment One